Supreme Court, U.S.
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No. 92-641

In The

Supreme Court of the United States

October Term, 1992

LEONARD NOBELMAN AND
HARRIET NOBELMAN,

Petitioners,

vs.

AMERICAN SAVINGS BANK,

Respondent.

**On Writ Of Certiorari To The
United States Court Of Appeals
For The Fifth Circuit**

BRIEF ON THE MERITS FOR RESPONDENT, STANDING CHAPTER 13 TRUSTEE

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STATEMENT OF THE ISSUES

WHETHER THE BANKRUPTCY COURT, DISTRICT COURT AND COURT OF APPEALS ERRED IN RULING THAT DEBTORS' CHAPTER 13 PLAN MAY NOT EMPLOY 11 U.S.C. SECTION 506 TO BIFURCATE A MORTGAGE LIEN CLAIM ON DEBTORS' PRINCIPAL RESIDENCE INTO ALLOWED SECURED AND UNSECURED CLAIMS AND PROVIDE FOR MODIFICATION OF THE ALLOWED UNSECURED CLAIM WITHOUT VIOLATING 11 U.S.C. SECTION 1322(b)(2)?

STATUTES WHICH THE CASE INVOLVES

11 U.S.C. Section 101. Definitions.

In this title –

(5) "claim" means –

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured; or

(B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured or unsecured.

(12) "debt" means liability on a claim.

(37) "lien" means charge against or interest in property to secure payment of a debt or performance of an obligation.

11 U.S.C. Section 349. Effect of Dismissal.

(b) Unless the court, for cause, orders otherwise, a dismissal of a case other than under Section 742 of this title –

(1) reinstates –

(B) any transfer avoided under Section 522, 544, 545, 548, 549, or 724(a) of this title, or preserved under Section 510(c)(2), 522(i)(2), or 551 of this title; and

(C) any lien voided under Section 506(d) of this title;

(3) revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case under this title.

11 U.S.C. Section 363. Use, sale, or lease of property.

(f) The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if –

(3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property.

(k) At a sale under subsection (b) of this section of property that is subject to a lien that secures an allowed claim, unless the court for cause orders otherwise the

holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property.

11 U.S.C. Section 502. Allowance of claims or interests.

(a) A claim or interest, proof of which is filed under Section 501 of this title, is deemed allowed, unless a party in interest, including a creditor of a general partner in a partnership that is a debtor in a case under Chapter 7 of this title, objects.

(b) Except as provided in subsections (e)(2), (f), (g), (h), and (i) of this section if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that –

(1) such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured;

(2) such claim is for unmatured interest;

(3) if such claim is for a tax assessed against property of the estate, such claim exceeds the value of the interest of the estate in such property;

(4) if such claim is for services of an insider or attorney of the debtor, such claim exceeds the reasonable value of such services;

(5) such claim is for a debt that is unmatured on the date of the filing of the petition and that is excepted from discharge under Section 523(a)(5) of this title;

(6) if such claim is the claim of a lessor for damages resulting from the termination of a lease of real property, such claim exceeds –

(A) the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease, following the earlier of –

(i) the date of the filing of the petition; and

(ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property; plus

(B) any unpaid rent due under such lease, without acceleration, on the earlier of such dates;

(7) if such claim is the claim of an employee for damages resulting from the termination of an employment contract, such claim exceeds –

(A) the compensation provided by such contract, without acceleration, for one year following the earlier of –

(i) the date of the filing of the petition; or

(ii) the date on which the employer directed the employee to terminate, or such employee terminated, performance under such contract; plus

(B) any unpaid compensation due under such contract, without acceleration, on the earlier of such dates; or

(8) such claim results from a reduction, due to late payment, in the amount of an otherwise applicable credit available to the debtor in connection with an employment tax on wages, salaries, or commissions earned from the debtor.

11 U.S.C. Section 506. Determination of secured status.

(d) To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void unless –

(1) such claim was disallowed only under Section 502(b)(5) or 502(e) of this title; or

(2) such claim is not an allowed secured claim due only to the failure of any entity to file a proof of claim under Section 501 of this title.

11 U.S.C. Section 522. Exemptions.

(a) In this section –

(1) "dependent" includes spouse, whether or not actually dependent; and

(2) "value" means fair market value as of the date of the filing of the petition or, with respect to property that becomes property of the estate after such date, as of the date such property becomes property of the estate.

(b) Notwithstanding Section 541 of this title, an individual debtor may exempt from property of the estate the property listed in either paragraph (1) or, in the alternative, paragraph (2) of this subsection. In joint cases filed under Section 302 of this title and individual cases

filed under Section 301 or 303 of this title by or against debtors who are husband and wife, and whose estates are ordered to be jointly administered under Rule 1015(b) of the Bankruptcy Rules, one debtor may not elect to exempt property listed in paragraph (1) and the other debtor elect to exempt property listed in paragraph (2) of this subsection. If the parties cannot agree on the alternative to be elected, they shall be deemed to elect paragraph (1), where such election is permitted under the law of the jurisdiction where the case is filed. Such property is –

(1) property that is specified under subsection (d) of this section, unless the State law that is applicable to the debtor under paragraph (2)(A) of this subsection specifically does not so authorize; or, in the alternative,

(2)(A) any property that is exempt under Federal law, other than subsection (d) of this section, or State or local law that is applicable on the date of the filing of the petition at the place in which the debtor's domicile has been located for the 180 days immediately preceding the date of the filing of the petition, or for a longer portion of such 180-day period than in any other place; and

(B) any interest in property in which the debtor had, immediately before the commencement of the case, an interest as a tenant by the entirety or joint tenant to the extent that such interest as a tenant by the entirety or joint tenant is exempt from process under applicable nonbankruptcy law.

(c) Unless the case is dismissed, property exempted under this section is not liable during or after the case for any debt of the debtor that arose, or that is determined

under Section 502 of this title as if such debt had arisen, before the commencement of the case, except –

(2) a debt secured by a lien that is –

(A)(i) not avoided under subsection (f) or (g) of this section or under Section 544, 545, 547, 548, 549, or 724(a) of this title; and

(ii) not void under Section 506(d) of this title; or

(B) a tax lien, notice of which is properly filed; or

(g) Notwithstanding Sections 550 and 551 of this title, the debtor may exempt under subsection (b) of this section property that the trustee recovers under Section 510(c)(2), 542, 543, 550, 551, or 553 of this title, to the extent that the debtor could have exempted such property under subsection (b) of this section if such property had not been transferred, if –

(1)(A) such transfer was not a voluntary transfer of such property by the debtor; and

(B) the debtor did not conceal such property;

11 U.S.C. Section 524. Effect of discharge.

(a) A discharge in a case under this title –

(2) operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor, whether or not discharge of such debt is waived; and

(3) operates as an injunction against the commencement or continuation of an action, the employment of

process, or an act, to collect or recover from, or offset against, property of the debtor of the kind specified in Section 541(a)(2) of this title that is acquired after the commencement of the case, on account of any allowable community claim, except a community claim that is excepted from discharge under Section 523, 1228(a)(1), or 1328(a)(1) of this title, or that would be so excepted, determined in accordance with the provisions of Sections 523(c) and 523(d) of this title, in a case concerning the debtor's spouse commenced on the date of the filing of the petition in the case concerning the debtor, whether or not discharge of the debt based on such community claim is waived.

(e) Except as proved in subsection (a)(3) of this section, discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt.

11 U.S.C. Section 1307. Conversion or dismissal.

(b) On request of the debtor at any time, if the case has not been converted under Section 706, 1112, or 1208 of this title, the court shall dismiss a case under this chapter. Any waiver of the right to dismiss under this subsection is unenforceable.

11 U.S.C. Section 1322. Contents of plan.

(b) Subject to subsections (a) and (c) fo this section, the plan may –

(5) notwithstanding paragraph (2) of this subsection, provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due.

11 U.S.C. Section 1325. Confirmation of plan.

(a) Except as provided in subsection (b), the court shall confirm a plan if –

(5) with respect to each allowed secured claim provided for by the plan –

(A) the holder of such claim has accepted the plan;

(B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and

(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or

(C) the debtor surrenders the property securing such claim to such holder.

11 U.S.C. Section 1327. Effect of confirmation.

(b) Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.

(c) Except as otherwise provided in the plan or in the order confirming the plan, the property vesting in the

debtor under subsection (b) of this section is free and clear of any claim or interest of any creditor provided for by the plan.

11 U.S.C. Section 1328. Discharge.

(a) As soon as practicable after completion by the debtor of all payments under the plan, unless the court approves a written waiver of discharge executed by the debtor after the order for relief under this chapter, the court shall grant the debtor a discharge of all debts provided for by the plan or disallowed under Section 502 of this title, except any debt –

(1) provided for under Section 1322(b)(5) of this title.

STATEMENT OF THE CASE

Course of the Proceedings and Disposition in Courts Below. The United States Bankruptcy Court for the Northern District of Texas, Honorable Harold C. Abramson presiding, entered on February 12, 1991, its Findings of Fact and Conclusions of Law denying Confirmation of the Chapter 13 Plan of Leonard and Harriet Nobelman. The Nobelmans appealed and on June 24, 1991, the United States District Court for the Northern District of Texas, Honorable Barefoot Sanders presiding, entered its Memorandum Opinion and Order affirming the decision of the Bankruptcy Court. The Nobelmans appealed from that Order to the United States Court of Appeals for the Fifth Circuit, which affirmed the decision below on

August 13, 1992, and Certiorari was subsequently granted by this Court.

STATEMENT OF FACTS

The facts presented in this appeal are essentially undisputed. American Savings Bank, F.A. (hereinafter "A.S.B.") is the owner and holder of an adjustable rate note executed by the Nobelmans on June 21, 1984, in the amount of $68,250.00 (the "Note"). The Note is secured by a purchase money Deed of Trust on a condominium which is the Nobelmans' principal residence. The Note provides for an initial rate of interest of 7.5%, which is to be adjusted every 12 months through 1987 and every 60 months thereafter, beginning August 1, 1987, until maturity on July 1, 2014. Payment amounts are specified in the Note until the 1987 adjustment, after which the adjusted payments are to be calculated on the basis of the new interest rate, the outstanding principal and the remaining term of the loan. Murray Mortgage Company is the duly authorized servicing agent for A.S.B.

The Nobelmans filed a voluntary Chapter 13 Bankruptcy Petition on August 6, 1990. On August 14, 1990, A.S.B. filed its Proof of Claim for $71,265.04, which was amended on October 2, 1990, to $71,335.04. On October 25, 1990, the Nobelmans filed their Modified Chapter 13 Plan and Motion for Valuation ("Plan"), which valued the residence at $23,500.00. The Plan proposed to pay direct to A.S.B. only that amount as a secured portion of its claim, and proposed to cure pre-Petition arrearages through the Plan. The balance of the claim would be

treated through the Plan as a general unsecured claim. The Plan makes no provision regarding the method of amortization of principal and interest as a result of the adjustment of the rate of interest in accordance with the Note and/or the "cramdown" provided for in the Plan.

On November 5, 1990, A.S.B., through its agent, filed its Objection to Confirmation of the Nobelmans' Plan. The Objection stated that the Plan violated 11 U.S.C. Section 1322(b)(2) by impermissibly modifying A.S.B.'s claim. Tim Truman, predecessor to Molly Bartholow, Standing Chapter 13 Trustee, filed his Objection to Confirmation on November 27, 1990, also asserting that the Plan violated Section 1322(b)(2). The hearing on Confirmation was held on December 6, 1990. No party offered evidence controverting the valuation placed by the Nobelmans on their residence. On February 14, 1991, the Bankruptcy Judge entered his Findings of Fact and Conclusions of Law, sustaining the objections of A.S.B. and the Trustee. That ruling by the Bankruptcy Court was affirmed by the District Court and the United States Court of Appeals for the Fifth Circuit.

SUMMARY OF THE ARGUMENT

Appellants argue that Section 506(a) of the Federal Bankruptcy Code should be able to effect a "strip down" of the Nobelmans' homestead mortgage holder's lien. Only after the 506(a) "strip down" do Appellants apply 1322(b)(2) to assert that the then stripped claim of the mortgage lender can be modified so as to avoid payment of the undersecured portion of the debt, a "Zero Percent"

dividend can be paid to unsecured creditors and the debtors' liability thereon can be discharged if all plan payments are made.

Respondent-Trustee maintains that both assertions by the Appellants are incorrect.

This Court in its recent opinion, *Dewsnup v. Timm*, 112 S.Ct. 773 (1992), made clear that 506(a) did not provide debtors with a "broad new remedy" involving the right to "strip down" liens solely because of a lack of equity. The *Dewsnup* case is illustrative of the present Chapter 13 case because this court was unequivocal that 506(a) "strip down" of liens was not a permissible remedy in the Chapter 7 context. Consequently, without a reorganization chapter's extra "cram down" powers, neither the general provisions of the Bankruptcy Code nor the provisions of Chapter 7 authorized the Section 506 "strip down" requested by the *Dewsnups*. Appellants' argument herein fails since their 1322(b)(2) analysis springboards entirely upon an affirmative finding that, by itself, 506(a) had worked a lien "strip down" which finding was specifically denied in *Dewsnup* and by the Fifth Circuit in *In re Nobelman*, 968 F.2d 483 (5th Cir. 1992).

Respondent-Trustee maintains that Section 506(a) is not a self actualizing section that is capable of altering secured debt. Instead, 506(a) is designed to assist the bankruptcy process to be able to determine the value of a secured claim at different times and for different purposes throughout a bankruptcy case. It cannot act by itself to affect a creditor's interest and can only be applied in conjunction with some other action dealing

with a proposed disposition, use or plan. If Section 506(a) does not by itself affect a secured debt, some other action taken in the bankruptcy case must serve as the catalyst to kick off Appellants' requested relief of debt "strip down."

Section 1322(b)(2) is the only other section relied upon by the Appellants to support their theory that the homestead debt and lien herein may be "reduced." The mandate in the "other than" clause of Section 1322(b)(2) against a plan provision that would modify the "rights" of holders of a claim secured by the debtors' homestead prevents the Nobelmans' plan from reducing the homestead mortgage debt, whether by way of Section 506(a) or otherwise. Post-*Dewsnup* cases to the contrary, such as *Bellamy v. Federal Home Loan Mortgage Co.*, 962 F.2d 176 (2d Cir. 1992), do not properly apply *Dewsnup* or interpret the import of the "other than" clause. They fail to recognize that Section 1322(b)(2) broadly prohibits modification of a lienholders's rights, and they misread Section 506(a) in relation to Section 1322(b)(2).

Neither statutory construction rules nor legislative history support Appellants' argument for the application of 506(a) and 1322(b)(2) to "strip down" liens of homestead mortgage holders. The Fifth Circuit held that the plain meaning of 506(a) and 1322(b)(2) appeared to conflict. Consequently, in *Nobelman* the Fifth Circuit held that the specific provisions of 1322(b)(2) controlled over the general provisions of 506(a) and, after review of the legislative history of 1322(b)(2), determined that 1322(b)(2) prohibits the modification of the "rights" of holders of claims secured by a home mortgage and that the claim, both secured and unsecured, if any, could not be modified.

Finally, the Bankruptcy Code does not support the concept of the "strip down of liens" outside the special provisions found in the reorganization chapters that allow "cram down" in limited exceptions to the general rule. Just like it is hard to see the whole picture when you can only see two strands of thread in a tapestry, it is hard to see the whole bankruptcy picture if you focus only on 506(a) and 1322(b)(2). It is imperative to look at the whole fabric of the Bankruptcy Code to understand its purpose. Here, the Appellants' proposed 506(a) "strip down" must be put in context with other sections of the Code that would be impacted such as 502 allowance of claims, 524 and 1328 discharge, 363 sales of assets, 349 dismissals and with regard to a Chapter 13 plan, the interplay of 1322(b)(2) with 1322(b)(5) long term debt, 1325(a)(5) confirmation, and 1327 (b) and (c) vesting of property in the debtor after the confirmation of a Chapter 13 plan. A review of these other key sections makes clear that the bankruptcy picture does not convey that liens be "stripped" except in very limited circumstances which circumstances do not include Chapter 13 homestead mortgages. In this regard, the Fifth Circuit in *Nobelman* specifically acknowledged the Second Circuit's *Bellamy* decision but rejected *Bellamy*'s ruling permitting 506(a) bifurcation of home mortgage claims.

ARGUMENT AND AUTHORITIES

I. The teachings of Dewsnup: The Scope of Section 506(a).

In *Dewsnup v. Timm*, 112 S.Ct. 773 (1992) this Court considered the relationship of Sections 506(a) and (d) in the context of a Chapter 7 case. That case clearly established that Section 506(a) is not to be mechanistically applied to bifurcate liens for all purposes. Rather, Section 506(a)'s impact must be considered in the overall context of the Code and pre-Code practice and provisions. *Dewsnup* teaches that Section 506(a) does not, by itself, provide a basis for avoiding a lien on the undersecured portion of a secured debt. Instead, Section 506(a) merely sets forth a basis for establishing relative values in order to enable a fair distribution to secured and unsecured creditors.

Although Section 506(a) is an element of the lien-splitting equation, *Dewsnup* requires an additional statutory catalyst to effectuate the remedy sought by the debtor. In *Dewsnup*, this Court considered and rejected the Chapter 7 debtor's argument that Section 506(d) was the catalyst that allowed him to reduce the secured claim to its present value and void the secured creditor's lien. In doing so, it declined to create a remedy under Section 506(a) that was not clearly articulated in the Code or the legislative history:

> "When Congress amends the bankruptcy laws, it does not write 'on a clean slate'. Furthermore, this Court has been reluctant to accept

> arguments that would interpret the Code, however vague the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history. Of course, where the language is unambiguous, silence in the legislative history cannot be controlling. But given the ambiguity here, to attribute to Congress the intention to grant a debtor the broad new remedy against allowed claims to the extent that they become 'unsecured' for purposes of Section 506(a) without the new remedy's being mentioned somewhere in the Code itself or in the annals of Congress is not plausible, in our view, and is contrary to basic bankruptcy principles." *Dewsnup*, at 779. [Citations omitted.]

As the Court points out, there is nothing in Section 506(a) or the provisions of the Code with which it interacts to serve as grounds for a dramatic change in pre-Code principles that allow survival of liens *in rem* in order to allow secured creditors adequate rights, not inconsistent with the purposes of the Code, to realize maximum benefit from its collateral.[1]

To this end the Court considered favorably the arguments that the "fresh start" doctrine does not extend to discharge an *in rem* claim against property, but that creditors should retain the benefit of their liens:

> "We think, however, that the creditor's lien stays with the real property until the foreclosure. That is what was bargained for by the mortgagor and the mortgagee. . . . *Any increase*

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[1] See the related discussion in Section IV below.

over the judicially determined valuation during the bankruptcy rightly accrues to the benefit of the creditor, and not to the benefit of the debtor and not to the benefit of the unsecured creditors whose claims have been allowed and who had nothing to do with the mortgagor-mortgagee relationship." *Dewsnup*, at 778. (emphasis added).

II. Application of Dewsnup to Nobelman.

The concepts articulated by this Court in *Dewsnup* are directly analogous in this case. Just as in *Dewsnup*, the Nobelmans seek first to apply Section 506(a) to reduce the amount of the secured claim on their home and then to invoke Section 1322(b)(2) as the catalyst to void the undersecured portion of the lien and discharge the unsecured claim which they seek to establish through application of Section 506(a).[2]

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[2] Cases decided at the Circuit court level permitting bifurcation of homestead liens include: *In re Hougland*, 886 F.2d 1182 (9th Cir. 1989); *Wilson v. Commonwealth Mortgage*, 895 F.2d 123 (3rd Cir. 1990); *In re Hart*, 923 F.2d 1410 (10th 1991); *Sapos v. Provident Institution of Savings*, 967 F.2d 918 (3d Cir. 1992); *Bellamy v. Federal Home Loan Mortgage Co.*, 962 F.2d 176 (2d Cir. 1992); and *Lomas Mortgage USA v. Wiese*, 1992 WL 354917 (9th Cir. 1992). Cases refusing to permit bifurcation include: *In Boullion*, 123 B.R. 549 (Bkrtcy. W.D. Tex. 1990). *In re Sauber*, 115 B.R. 197 (Bkrtcy. D. Minn. 1990); *In re Christiansen*, 121 B.R. 63 (Bkrtcy. D. Colo. 1990); *In re Moreland*, 124 B.R. 921 (Bkrtcy. D. Conn. 1991); *In re Mitchell*, 125 B.R. 5 (Bkrtcy. 1991); *In re Etchin*, 128 B.R. 662 (Bkrtcy. W.D. Wis. 1991). Lower court decisions in the Fifth Circuit permitting bifurcation include: *In re Session*, 128 B.R. 147 (Bkrtcy. E.D. Tex. 1991); *Federal Sav. Bank v. Dunlap*, (E.D. La. 1991); and *In re Franklin*, 126 B.R. 702 (Bkrtcy. N.D. Miss. 1991).

However, as in the case of Section 506(d), the Code and the legislative history of Section 1322(b)(2) are devoid of clearly articulated indications that Congress intended the "broad new remedy" which the Nobelmans seek to establish.[3] Accordingly, Section 1322(b)(2) is likewise not the catalyst that charges Section 506(a) with the power to bifurcate or void liens.

The legislative history of Section 1322(b)(2) indicates that the "other than" clause was inserted into Section 1322(b)(2) in response to perceived needs for protection of the home mortgage industry.[4] Prior law precluded any cramdown of any "estates in real property"[5] and there is no indication in the legislative history of Section 1322(b)(2) that the protective exception in the "other than" clause was intended to permit a cramdown of home mortgages.

Indeed, the *Nobelman* decision below finds that the legislative history as an additional basis for its holding, pointing out that in the Congressional negotiations the Senate receded from its position that there be "no modification" of real estate liens and acquiesced in a provision that precluded modification of home mortgages only.

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[3] The marked split in authority on this issue makes it self-evident that the Code itself does not provide the clear delineation of new remedies that *Dewsnup* requires.

[4] Brief of Appellant, at 13-17; *Bellamy*, 962 F.2d 176, 181-182 (2d Cir. 1992). Amicus briefs in support of Respondents' position in this case delineate the specific concerns of the thrift industry.

[5] *Bellamy*, 962 F.2d 176, 181 (2d Cir. 1992).

Acknowledging an apparent need to provide stability and protection to the thrift industry, the court concluded:

> "We believe our interpretation of Section 506(a) and Section 1322(b)(2) reflects this compromise. . . . The bifurcation of an undersecured home mortgage runs afoul of the specific protection afforded under Section 1322(b)(2) to home mortgage creditors whose claims are secured only by a debtor's principal residence. Section 506(a) cannot be used to bifurcate the claim and vitiate the protection of Section 1322(b)(2)." 968 F.2d 489.[6]

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[6] *See also In re Sauber*, 115 B.R. 197 (Bankr. N.D. Minn. 1990), in which the court noted that Congress had clearly provided home mortgagees with protection in their treatment under the Bankruptcy Code, and the only explicit exception is the Section 1322(b)(5) cure provision. As stated by Judge O'Brien:

> "That Congress has provided certain home mortgagees with protection against the modification of their rights which might otherwise result through application of Section 506(a) in Chapter 13 cases, is a simple and logical conclusion, readily drawn from reading Sections 1322(b)(2) and (b)(5). And, it is not surprising. The vast majority of Chapter 13 cases are filed by homeowners, and most plans treat mortgage defaults. Sections 1322(b)(2) and (b)(5), in a relatively simple and straight-forward manner, protect the home loan industry from perceived adverse consequences that might otherwise result from general application of Section 506(a) to it in Chapter 13 cases.
>
> "The protection afforded preserves the integrity of the mortgage contract, with the limited exception of allowing a debtor a reasonable period in which to cure defaults." *Id.*, at 199.

Nobelman also holds that the more specific provisions of Section 1322(b)(2) should govern over the general provisions of Section 506(a). This, by itself, provides a sound basis for affirming the decision below.

Cases such as *Bellamy*,[7] decided after *Dewsnup*, fail to interpret Section 1322(b)(2) as precluding lien splitting. In so doing, they do not apply *Dewsnup* correctly, since they fail to follow *Dewsnup*'s teachings that Section 506(a) does not, by itself, support bifurcation of liens.

Bellamy distinguishes *Dewsnup* on the basis of "differing language" in 506(d) and 1322(b)(2), and asserts that both 1322(b)(2) and 506(a) deal with "secured claims," whereas 506(d) was concerned with "liens." This analysis misses the mark. As discussed in more detail below, Section 1322(b)(2) deals with "rights," not claims, and specifically prohibits modification of the rights. Moreover, the *Bellamy* court's interpretation of Section 1322(b)(2) could not have a more direct impact on the liens in question since the effect of its ruling is to render valueless important aspects of a secured creditor's lien.

The assertion that Section 506(a) deals with claims and not liens is correct[8], but absent other provisions to implement it, the effect is only to establish relative rights to distribution with respect to claims treated in a Chapter 13 plan. Its purpose is to enable an equitable distribution

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[7] The *Bellamy* decision provides the most thorough post-*Dewsnup* analysis in support of lien stripping and will accordingly be discussed in some detail in this brief.

[8] Indeed, the word "lien" does not appear in Section 506(a), and yet Petitioner seeks to use it as the springboard for voiding the liens of a secured creditor.

among secured and unsecured creditors and not as a sword with which to void liens. As was the case with respect to Section 506(d) in *Dewsnup*, the broader power to limit or eliminate rights, claims or liens protected by 1322(b)(2) is nowhere contained in Section 506(a).

Bellamy and those cases which follow it pay lip service to *Dewsnup* and Section 1322(b)(2) with statements to the effect that "bifurcation" under 506(a) is somehow not a "modification" under Section 1322(b)(2). They purport to give meaning to the "other than" clause by acknowledging the obvious intent which it embodies to "provide greater protection to home mortgage lenders than other secured creditors in the Chapter 13 context" and conclude that this objective is met by precluding a reduction in the mortgage payment pending payout of the bifurcated secured claim.[9] Thus is it dubiously maintained that a nominal change in interest rate or payment amount on the Nobelmans' homestead note would constitute an impermissible modification of the lender's rights, while a $50,000 reduction in the principal amount owing does not.

Aside from the questionable logic of this position, it is itself a non-sequitur: since the contractual payment terms relate both to the secured and unsecured portion of the bifurcated claim, the requirement that they may not be altered imposes restrictions on modification that go beyond the narrow limits of the secured portion of the

[9] *See e.g., Bellamy*, 962 F.2d at 184-5.

claim.[10] Moreover, interpreting the "other than" clause in this fashion renders it largely redundant with Section 1325(a)(5)(B)(ii), which guarantees, even absent Section 1322(b)(2), that the holder of a secured claim will receive the value of the secured portion of the claim. Therefore the minimal rights which would be protected from modification under this interpretation are largely illusory.

The application of these concepts becomes even more tenuous when, as in the instant case, the note and lien in question provide for adjustment in the payment amounts based on an adjustable rate of interest. In these circumstances, the applicable contractual provisions normally require the payment to be adjusted to reflect the actual interest rate and principal amount on each adjustment date. Do those cases which hold that a change in the amount of payment is a modification of the noteholder's rights require that the adjusted payment be computed on the basis of the face amount of the loan or of the reduced

[10] Courts applying this principle have developed a variety of interpretations and refinements dealing with particular individual circumstances. *See e.g., In re Brouse*, 110 B.R. 539, 544 n.7 (Bankr. D. Colo. 1990) (no change in interest rate); *In re Honett*, 116 B.R. 495, 497-98 (Bankr. E.D. Tex. 1990); *In re Hayes*, 111 B.R. 924, 926-27 (Bankr. D. Or. 1990) (no change in payments or interest rate); *In re Hyden*, 110 B.R. 46, 51, clarified & motion for reconsideration denied, 112 B.R. 431 (Bankr. W.D. Okla. 1990) (no change in payments or interest rate); *In re Demoff*, 109 B.R. 902 (Bankr. N.D. Ind. 1989) (duty to pay insurance and taxes and duty not to commit waste remains unaffected); *In re Morphis*, 30 B.R. 589, 593-94 (Bankr. N.D. Ala. 1983) (a reduction of the monthly payment is permissible because the mortgagee is entitled to the same treatment mandated under Section 1325(a)(5)(B)).

and bifurcated amount of the secured claim? If the former, how will the amortization of principal and interest be determined? If the latter, literal application of the contractual provision would "protect" a secured creditor by mandating a much reduced payment over the original term of the loan. That the Code and the legislative history of Section 1322(b)(2) make no provision for these questions and afford the federal judiciary no guidance as the methods to be employed in re-amortizing the debtors' loans is an additional indication that Congress did not intend Section 1322(b)(2) to authorize lien stripping.

III. Analysis of Section 1322(b)(2).

Section 1322(b)(2) provides as follows:

> "(b) Subject to subsections (a) and (c) of this section, the plan may –
>
> (2) modify the *rights of holders* of secured claims, *other than a claim secured only by a security interest in real property that is the debtor's principal residence*, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims." (emphasis added)

A critical element of Appellant's argument in this case is that the "other than" clause highlighted above must be read to modify the words "secured claims" solely and only because those words directly precede the clause itself. This is only one of several possible constructions, and it does not comport with the common sense meaning of the "other than" clause.[11]

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[11] See note 6 supra and related text.

Respondent-Trustee submits that a reading of this provision with the implied addition for clarification of the bracketed language indicated below is equally plausible grammatically, and better suits the overall workings of the Code and the Congressional intent:

> "(2) modify the rights of holders of secured claims, other than [*the rights of a holder of*] a claim secured only by . . . "

This reading properly shifts the emphasis of the provision to one which is designed to protect the *rights of holders* of claims, not just the claims themselves and underscores the intention of Congress to protect the *holders* of secured claims from any modification of their rights.

For example, *Bellamy* specifically acknowledges Section 1322(b)(2) precludes modification of "rights."[12] It casts the issue as whether this means rights of the "holder" of a claim which happens to be secured, or whether it is addressing the holder's rights with respect only to the "secured claim." The court parrots a supposed "cornerstone" of the Code that "treatment under the Code turns on whether a *claim* is secured or unsecured, not whether a *creditor* is secured or unsecured,"[13] ignoring the fact that express language of 1322(b)(2) speaks of the "rights of a holder" of a secured claim.

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[12] "Acknowledging that [Section 1322(b)(2)] prohibits modification or a residential mortgagee's rights does not answer the ultimate question to be decided – what are those rights?" *Bellamy*, 962 F.2d at 179.

[13] *Bellamy*, 962 F.2d, at 179.

This rote application of a sometimes valid principle is not warranted here. Significantly, the phrase "rights of a holder" is unique in the Code to Sections 1322(b)(2) and 1222[14]. Thus, the cases relied on in *Bellamy* for this proposition are interpreting different statutory language. In contrast, it is patently untenable to assert that the words "rights of holders of secured claims" makes reference only to claims and somehow does not address the holders themselves and their rights.

The *Bellamy* court also attempts to differentiate between "rights" (which are said to arise under state law) and the "manner in which the rights are satisfied" (which is said to be fixed by the Code and not a "right" protected by the "other than" clause).[15] In doing so, it invokes the Code's definition of "claim" (Section 101(5)(A)) as "right to payment" and implicitly postulates that the right to payment is thus equivalent to a claim[16] and therefore not one of the state law "rights" protected by the "other than" clause. Having thus defined a right specified in the Code as a mere "claim," it then concludes that since the Code and not state law govern the manner of payment of claims, "bifurcation" and cramdown is not a "modification" of the right/claim, only a determination of how the right/claim is to be satisfied.

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[14] Section 1222 is patterned after 1322, but does not include the "other than" clause. It was enacted with Chapter 12 in 1985, so the differences between Sections 1322 and 1222 are not relevant to a consideration of the legislative intent when Section 1322 was enacted in 1978.

[15] *Bellamy*, 962 F.2d at 179-80.

[16] This is like defining blue as a color and then concluding that all colors are blue.

This logic is circular and assumes the conclusion in two respects. First, the right to payment is indeed one of the bundle of rights available to a holder of a claim.[17] Under *Dewsnup*, the bundle must necessarily include a right to receive "any increase over the judicially determined valuation," which "rightly belongs to the creditor."[18] But it certainly does not follow from the Code's reference to this right in its definition of a "claim" that the holder of a claim has no cognizable rights other than the right to payment. Second, it assumes that the holder of a claim has no rights in determining how a claim is to be satisfied. Once again, the court assumes its conclusion, overlooking the essence of the issue at hand. The very

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[17] These rights include:

"1. The right to retain the lien until the indebtedness thereby secured is paid.
2. The right to realize upon the security by a judicial public sale.
3. The right to determine when such sale shall be held, subject only to the discretion of the court.
4. The right to protect its interest in the property by bidding at such sale, whenever held, and thus to assure having the mortgaged property devoted primarily to the satisfaction of the debt, either through receipt of the proceeds of a fair competitive sale or by taking the property itself.
5. The right to control meanwhile the property during the period of default, subject only to the discretion of the court, and to have the rents and profits collected by a receiver for the satisfaction of the debt." *In re Barnes*, 146 B.R. 854 (Bankr. W.D. Okla 1992) citing from *Louisville Joint Stock Bank v. Radford*, 295 U.S. 555, 594-595, 55 S.Ct. 854, 865, 79 L.Ed. 1593 (1935).

[18] *Dewsnup*, at 778, quoted supra.

right that the mortgage holder seeks in this case to preserve is the right to determine the manner of payment under terms embodied in the mortgage and contractually committed to by the debtor.

Bellamy also supports its interpretation of the statute and the legislative history by reference to oft-cited principles embodied in the Code and Chapter 13 – those of fostering a "fresh start" and "favoring reorganization," suggesting that these principles require a reading of Section 1322(b)(2) that denies it any substantive meaning. Laudable as those principles may be, they are obviously subject to reasonable limits in their applicability. They do not guarantee reorganizations that are clearly not feasible under applicable laws and do not mandate a "fresh start" that permits every debtor an equity interest in a home, free from the threat of foreclosure or eviction on account of debts they cannot support.[19]

The *Bellamy* court begins its opinion with a statement in the first sentence that "Congress in the Bankruptcy Code provided that residential mortgages secured by liens could be broken down into two parts."[20] In discussing the options available to the debtor in that case it states: "If appellant's definition of modification (as encompassing bifurcation) was correct, a debtor wishing

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[19] *Cf. Dewsnup*, 112 S.Ct. at 777, wherein this Court quoted favorably from the respondent's argument:

"[T]he 'fresh start' policy cannot justify an impairment of respondents' property rights, for the fresh start does not extend to an *in rem* claim against property, but is limited to a discharge of personal liability."

[20] *Bellamy*, 962 F.2d at 177.

to retain his overencumbered home would face this quandry – pay off its actual value within five years (most likely an impossible proposition, thereby precluding confirmation (see Section 1325(a)(6)), or pay more than market value."[21] The court's analysis overlooks Section 1325(a)(5)(C) which affords the debtor a third alternative provided by Congress in a case such as this: "the debtor surrenders the property securing such claim to such holder."

From the perspective of a standing Chapter 13 Trustee, Respondent-Trustee respectfully submits that there is a substantial number of cases in which resort to 1325(a)(5)(C) is the only appropriate alternative of those outlined by the *Bellamy* court. A decision by this Court that makes it possible to achieve a substantial reduction in an undersecured homestead mortgage by the simple expediency of filing a Chapter 13 bankruptcy will open the door for widespread abuse of the bankruptcy system.

IV. Section 1322(b)(2) in the Context of the Bankruptcy Code.

Bankruptcy is a process whereby the debtor presents his nonexempt property for the payment of his allowed claims in exchange for the debtor obtaining a discharge of debts. The bankruptcy process, then, requires the debtor to disclose and value assets, creditors to state amounts due by the debtor and the basis therefor, payment of the claims allowed and ultimately, discharge for the debtor.

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[21] *Id.*, at 185.

The holding is *Dewsnup* that the secured creditor's lien passed through the bankruptcy is consistent with the application and flow of the bankruptcy process and is supportive of the Fifth Circuit's holding in *Nobelman* that the homestead mortgage lien herein could not be bifurcated or debt reduced. As shown below the Bankruptcy Code consistently supports the concept that the secured creditor retains his lien and that the lien passes through bankruptcy.

Claims allowance pursuant to Section 502. With regard to claims, Section 502 provides that claims timely filed are allowed unless objected to. Note that Section 502(b) does not list as an authorized objection to secured claims a lack of equity in collateral pursuant to 506(a). In short, a mortgage holder has an allowed claim in bankruptcy if the lien is valid and the claim is timely filed. The issue of the value of collateral does not enter into the determination of the 502 allowance of the claim. *See Dewsnup* at 778. In the instant case, it is undisputed that no objection was raised to the allowance of the claim of the Nobelmans homestead mortgage lender.[22]

Discharge pursuant to 524 and 1328. As pointed out by this Court in *Dewsnup*, discharge in the Bankruptcy Code is designed to be a release of personal liability and not an

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[22] The Fifth Circuit has consistently held that a secured creditor with an allowed secured claim is not bound by a Chapter 13 plan when no objection to the claim has been filed. In such instances, the liens have been held to pass through the bankruptcy case unaffected. *Sun Finance Company, Inc. v. Howard*, 972 F.2d 639 (5th Cir. 1992), *Simmons v. Savell*, 765 F.2d 547 (5th Cir. 1985).

in rem release of lien. Section 524 and Section 1328, both support that view.[23]

Section 524(a)(2) provides that discharge operates as an injunction against various collection activities with regard to debt of the debtor "as a personal liability." Section 524(a)(3) allows an injunction to collection activities with regard to prepetition debt only on post petition acquired property. Consequently, creditors with a prepetition lien on prepetition property do not have the lien discharged nor the debt discharged by virtue of Section 524; however, the debt has become a nonrecourse debt that can be satisfied by the collateral only.

Section 524(e) again emphasizes that the debt remains after discharge by referring to the effect of discharge on transactions involving third parties. As set out in 524(e), third party non-debtors do not get a discharge and their property is not relieved from debt on account of a debtor's discharge.

Section 524(e) vividly illustrates that the debtor, at discharge, only gets a personal liability release. For example, encumbered realty owned in common by a debtor and a non-debtor is subject to foreclosure for the full amount of the mortgage debt notwithstanding the fact that one of the original mortgagors filed a bankruptcy case and obtained a discharge. If under these hypothetical facts the realty at foreclosure did not satisfy the mortgage debt, the lender could pursue the non-debtor for a personal judgment for the deficiency but the 524 discharge would prevent the lender from pursuing the

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[23] *Dewsnup*, at 778.

debtor. In short, Section 524 discharge does not include the concept of "stripping" of liens or of voiding of liens.

The discharge provided to Chapter 13 debtors in 1328(a) is effective only upon the completion by the debtor of all payments under the plan. Accordingly, discharge for the Nobelmans would not come for five years, assuming all plan payments were made. Further, 1328(a) is subject to exceptions to discharge including any debt provided for under Section 1322(b)(5) – long term debts. It is inescapable under the *Nobelman* undisputed facts that the Nobelmans wish to cure arrearages in their mortgage and reinstate the mortgage payments pursuant to their Chapter 13 plan. The issue then arises with regard to what benefit a possible bifurcation of the mortgage lender's claim could render to the Nobelmans if the lien would remain and the debt, both secured and unsecured, would not be discharged pursuant to 1328(a)(1) and 1322(b)(5).

The court in *Bellamy* addressed the discharge issue in a tortured manner. The Second Circuit there held that 506(a) allowed the bifurcation of the home mortgage lender's claim thus allowing the discharge of the unsecured portion of the claim and further held that 1322(b)(5) was properly used because the "stripped down" portion of the secured claim allegedly was paid pursuant to the mortgage terms. Although the *Bellamy* court does not explain it, the result in *Bellamy* is possible only because that court also, apparently, applied Section 506(d) to void the stripped down lien and eliminate the underlying debt. *Bellamy*, at 178. That is the ruse that allows the Second Circuit to avoid 1328(a)(1) *debt* discharge prohibition for long term debt treated pursuant to

1322(b)(5). The Second Circuit had to eliminate the *debt* or the 1328 discharge could not be granted. Consequently, the Second Circuit must have used 506(d) to reduce the debt, although this Court has held in *Dewsnup* that the 506(a) and 506(d) combination does not result in such debt reduction or lien voiding.

The Court should recall that in *Nobelman*, the application of 506(d) is not requested. This case is on appeal from a denial of plan confirmation. *Nobelman* is not an appeal from an adversary proceeding to determine the extent of a lien as was the case in *Bellamy*. *Bellamy*, at 178. Since there is no adversary proceeding in *Nobelman* to void the mortgage lien or allowed secured claim of the homestead mortgage lender, it is inescapable that the homestead mortgage *debt* and lien must escape discharge pursuant to 1328(a)(1). Consequently, bifurcation of the mortgage lender's secured claim pursuant to 506(a) is meaningless to the debtor in economic terms and does so much violence to Section 1322(b)(2)'s prohibition against the modification of the rights of holders of claims secured by debtors' homesteads that this Court should decline to authorize it.

A better reasoned opinion by a circuit court with regard to the interplay of 1322(b)(5) and 1328(a)(1) is the Seventh Circuit's opinion in *Chappell*.[24] The facts of *Chappell* were unusual because the Chapter 13 debtors voluntarily accelerated their mortgage to pay it in full through the plan. Consequently, the court ruled that the 1328(a)(1)

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[24] *Chappell v. Homebanc, Inc.*, 1993 W.L. 5886 (7th Cir., Jan. 14, 1993). The issue of 506(a) bifurcation was not relevant in *Chappell* because the lender was oversecured.

bar to discharge was inapplicable since the debtors were not seeking to apply 1322(b)(5) in their plan. The *Chappell* opinion discusses the "cure and maintain" option available to debtors through 1322(b)(5) applicable to home mortgages and the concomitant lack of discharge by 1328(a)(1). The debtor, with the "cure and maintain" option, exchanges the discharge for the long term pay out. The creditor is protected because it retains the lien "intact." The alternative option available to debtors, as explained by *Chappell*, is the "cram down" option which requires the debtor to pay the claim within the Chapter 13 plan. Interestingly, the Seventh Circuit in *Chappell* does not come up with a third option of not paying the claim in full, not preserving the lien but allowing the discharge.

This third option is the result in *Bellamy* which result was rejected by the Fifth Circuit in *Nobelman*. The *Bellamy* result cannot be squared with the concepts of discharge in 524 or 1328. In the general discharge section, 524, the prepetition lien passes through bankruptcy intact. In the special Chapter 13 discharge section, 1328(a)(1), the liens are also designed to pass through if the debt is not paid in the plan. The Bankruptcy Code defines "debt" at Section 101(12) as liability on a claim. What 1328(a)(1) provides is that "debt" is discharged except any "debts" provided for under Section 1322(b)(5).

Accordingly, when the Bellamys and the Nobelmans decided to use 1322(b)(5) to reinstate their mortgage loans, they elected that the mortgage *debt* not be discharged. It is important to note that 1322(b)(5) allows both unsecured and secured claims to have the "cure and maintain" option and correlative discharge bar of 1328(a)(1). Consequently, even if the Nobelmans could

"strip" their homestead mortgage lien, since the Nobelmans intend to use 1322(b)(5), both the secured and unsecured claims can be "cured and maintained" resulting in no discharge of the underlying homestead mortgage *debt*. Alternatively, if the homestead mortgage lenders secured claim is bifurcated, which Respondent denies is permissible, the *debt* is, nevertheless, not discharged and the unsecured portion remains as a nonrecourse lien on the homestead to the extent it is not paid through the plan.

Sales of assets pursuant to Section 363. Secured creditors are given two protections with regards to sales of property subject to their lien. First, a sale free of the secured creditor's debt must be for an amount sufficient to pay the secured debt, 363(f)(3), and second, the secured creditor may bid at a sale with his debt, 363(k).

Section 363(f)(3) allows sales free and clear of any interest in property only if " . . . such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property . . . ". Note that 363(f)(3) does not speak in terms of "allowed secured claims" but in terms of "liens." If the Appellants' reading of 506(a) were accurate, there would never be a need for 363(f)(3) because the debtor would always present the contract for sale as evidence of the market value of the realty and pursuant to 506(a) "strip down" the liens to authorize the sale at the purchase price and free of the lien. However, the Code is unequivocal. A sale free of a lien must be a sale at a price sufficient to pay the lien. If this Court were to accept the Appellants' reading of 506(a) and 1322, the Court would also need to be prepared to write off 363(f)(3). Respondent

Trustee asserts that there is a difference between a lien and a claim under the Code. As demonstrated in 363(f)(3) the lien controls the sale. The lien must be paid before the Bankruptcy Court will declare the sale "free and clear" of the lien. Consequently, the lien may be in an amount greater than the claim. As further support, the court should note that "lien" is a defined term in the Bankruptcy Code at Section 101(37) to mean a charge against or interest in property to secure the payment of a *debt* as opposed to a "claim."[25]

A practical application of why it is necessary for a 363(f)(3) sale to be for the full amount of all liens is seen when there is more than one title holder on the realty or obligor on the mortgage note. In that circumstance, suppose that only one of the co-obligors files bankruptcy. If there is a proposed sale in the bankruptcy for less than the full value of all liens, why should the non-debtor obtain a windfall of the reduction in debt by the property being judicially determined to be debt free without the

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[25] Since Section 506(a) does not purport to deal with debt but only with claims, 506(a) is not designed to cause the bankruptcy court to declare the property "free and clear" of liens as is contemplated in a 363(f)(3) sale. 506(a)'s purpose is to determine in the debtor's bankruptcy case the amount for distribution to an allowed secured claim without affecting the amount of the underlying debt as it relates to the mortgage lien on the realty or the indebtedness owed by non-debtor third parties. Another way of looking at it is that the debt with regard to the debtor becomes nonrecourse to the extent that the debt exceeds the court's 506(a) determined value. Nevertheless, as to non-debtor parties the debt remains undiminished (except for payment) and the lien also remains on the realty for the entire amount of the debt.

liens having been paid? What the Bankruptcy Code does instead is to require that the sales price cover all liens before the sale mortgage free can be forced upon the lienholders.[26]

Section 363(k) also gives lien holders the right to assert the full amount of the lien at the time of sale of property subject to the lien by permitting the holder of such an allowed claim to bid at the sale and set off the purchase price with the allowed claim. The "allowed claim" in the 363(k) context is the entire claim – both the previously determined 506(a) secured and unsecured portions. This reading of 363(k) is consistent with the concept that the *debt* secured by the lien is not diminished by 506(a). It is important to understand that 506(a) is a fluid concept in that the bankruptcy court may be required to have 506(a) hearings for different purposes and at different times in a bankruptcy case. If, in the 363(k) context, the realty had been previously valued under 506(a), that

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[26] It is important for this court to consider the implication of nondebtor obligors on mortgage notes. It is not infrequent that spouses will not both be debtors. Should one spouse get the windfall of the other spouse's Chapter 13 case? What if a divorce is pending and the realty is the major asset of the parties to the divorce? Should family law counsel treat each divorce to a bankruptcy to eliminate or decrease mortgages? Because of the rising costs of housing it is not unusual for children to have notes cosigned by parents or for home ownership to be joint ventured by investors. Why should non-filing investors or parents upon whose credit the original mortgage was made be given a reduction in debt because the debtor filed a bankruptcy? The Bankruptcy Code does not contemplate that the third parties get any reprieve from the debt or the mortgage lien.

previous valuation would not limit the lienholder's ability to bid the entire *debt* toward the sales price. Consequently, it is unlikely that the Nobelmans will be able to sell their home free of the mortgage debt even if the plan was confirmed.

Dismissals pursuant to Section 349. Dismissals pursuant to Section 349 demonstrate that a lien is not permanently "stripped down" by the application of Sections 506(a) and 506(d). Section 349 provides that a dismissal reinstates all liens "voided" under 506(d) or avoided under the strong arm powers of the Code.[27] In *Bellamy*, the debtor argued that the lack of equity in the realty caused the mortgage holder to have a secured claim pursuant to 506(a) only up to the value of the realty and that, presumably, pursuant to 506(d) the lien of the mortgage holder was void to the extent that the mortgage holder did not have an allowed secured claim. Obviously, the underlying lien in *Bellamy* was not gone nor void if it could be resurrected by dismissal.

In *Nobelman*, the debtors are not asserting the use of 506(d) to void the "stripped down" portion of the lien. Query, then, whether the 506(a) bifurcation of "claims" can have any voiding effect on a "lien" as requested by Appellants. It is doubtful that 506(a) by itself has any application if a bankruptcy case is dismissed.

The issue of the effect of dismissal on allegedly "stripped down" liens should be carefully considered by

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[27] Section 522(c)(2)(A)(ii) provides that exempt property is not liable for debt secured by a lien that is void pursuant to 506(d) unless the case is dismissed.

this court because of the frequent occurrence of dismissals in Chapter 13. Consider the effect of "voiding" a mortgage lien prior to all the plan payments being made. What if the debtor decided to sell the realty prior to the last plan payment but after the secured claim amount had been paid. If a hypothetical debtor paid the secured claim (determined as the market value of the home, as of the effective date of the plan) and, prior to the last plan payment, the debtor decided to sell the home for less than the prepetition mortgage debt, could the debtor give the buyers title free and clear of the lien of the mortgage holder? What if, after the sale, the debtor did not complete the plan payments and the Chapter 13 case was dismissed? Can the home mortgage lien reattach to sold property?

If the court determines that the post-confirmation sale of the realty must also comply with the home mortgage holders rights to be able to bid in the entire non-bifurcated claim at a sale pursuant to Section 363(f)(3), then the issue is, again, whether 506(a) or (d) has eliminated the lien but this time by some magic that occurs at confirmation. If confirmation is the only act a Chapter 13 debtor must take to eliminate or reduce a mortgage, the court must expect a wave of Chapter 13 bankruptcy filings for that sole purpose. Debtors will see no advantage in performing their plans if their major reason for filing is mortgage debt relief. As it is now, the courts are complaining because it appears that many debtors are staying in Chapter 13 only long enough to cure home arrearages and then are converting to Chapter 7. The Code did not build in such a blatant opportunity for abuse. Thanks to *Dewsnup* it is clear that the debtors cannot strip down a

mortgage in a Chapter 7 and this court should not allow a back door for the same result by allowing Chapter 13 strip down only as a prelude to Chapter 7.[28]

Interplay of 1322(b)(2) and 1322(b)(5) with regard to long term debt. Section 1322(b) sets out what a Chapter 13 plan "may" provide. Of particular interest is 1322(b)(2) and 1322(b)(5). These two sections have been the subject of much speculation from the early years of the Code because they relate to the treatment of long term secured creditors' claims in a Chapter 13 plan. Section 1322(b)(2) provides that a Chapter 13 plan may modify the "rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims . . . " Section 1322(b)(5) provides that a Chapter 13 plan may "notwithstanding paragraph (2) of this subsection, provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due".

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[28] The debtor has two powerful tools in a Chapter 13 reorganization, the power to dismiss the case and the power to propose the plan. Section 1307(b) gives the debtor the right at any time to request a dismissal and the court "shall" dismiss. Section 1321 provides that only the debtor can propose a plan. The bane of Chapter 13 has been the repetitive filer that dismisses when a lift of stay is granted only to refile shortly thereafter. Since the home mortgage lender is not allowed to propose a plan and cannot prevent dismissal, an unscrupulous debtor can keep such a creditor at bay and without payment for months.

Initially, the courts debated whether 1322(b)(5) allowed the debtor to decelerate a home mortgage and make a cure of missed payments over a reasonable time during the Chapter 13 case. Those cases, for the most part, declared that such a cure was possible because the Code allowed that one invasion on the mortgage holders rights in 1322(b)(5) as specifically provided "notwithstanding paragraph (2)". A cure of arrearages was held not to be a modification violative of 1322(b)(2) which does not allow any modification of the rights of holders of a claim secured only by a security interest in the debtors homestead. See, *DiPierro v. Taddeo*, 685 F.2d 24, 27-29 (2d Cir. 1982); *Grubbs v. Houston First American Savings Association*, 730 F.2d 236, 243-246 (5th Cir. 1984).

The Appellants in the instant case appear to take the position that they are not relying on 1322(b)(5). Nevertheless, the Nobelmans expect to pay their mortgage (bifurcated and crammed down or not) beyond the length of their Chapter 13 plan. Accordingly, the Nobelmans appear to be taking the position of the *Bellamy* court that the home mortgage lien itself is reduced upon the confirmation of the Chapter 13 plan by taking the position that the secured claim is the bifurcated portion of the mortgage debt and that the stripped mortgage is "maintained" pursuant to 1322(b)(5). *Bellamy*, at 185, 186. Even if this position would allow confirmation, which Respondent-Trustee denies, it would not give the debtors a discharge as stated above.

As set out in the *Taddeo* and *Chappell* cases, the legislative history of 1322(b)(5) is clear that a reduction of payment of the mortgage debt was a modification prohibited on home mortgages but the cure of arrearages and

the reinstatement of the mortgage with the lien intact, was not a modification prohibited by 1322(b)(2) or 1322(b)(5).

Bellamy's result of an absolute reduction of the mortgage debt and lien seems irreconcilable with the plain meaning of 1322(b)(2) and 1322(b)(5) especially when dismissal pursuant to 349 would reinstate the lien, discharge of long term debts are excepted in 1328(a)(1), and confirmation in 1325(a)(5)(B) requires secured creditors to retain their liens. The Fifth Circuit's holding in *Nobelman* that 1322(b)(2) prohibited the modification of the rights of homestead mortgage lenders and that the proposed 506(a) bifurcation of the home mortgage was such an impermissible modification of rights is consistent with the overall context of the Bankruptcy Code and therefore, is a better approach than *Bellamy*.

Confirmation pursuant to 1325(a)(5) and post confirmation vesting of property pursuant to 1327(b) and 1327(c). The provisions of 1325(a)(5) relate to the requirements of confirmation for the treatment of secured claims and 1327 vests property in the debtor subject to the provisions in the plan and order of confirmation.

The court is directed by the Code, at 1325(a), that it "shall" confirm if, with regard to allowed secured claims, the creditor accepts the plan, the collateral is surrendered to the creditor, or the plan provides that the holder of the claim retain the lien and that the value of the property paid thru the plan to the secured creditor is not less than the allowed claim. By requiring that the lien be retained, the Code prevents the property from being vested at confirmation to the debtor "free and clear" of any interest

of any creditor provided for in the plan pursuant to 1327(b) and 1327(c). In short, the Nobelmans cannot shake a security interest on their home and have the plan confirmed unless the secured creditor agrees to it.[29]

The relief that the Appellants request is just not in the Code. Further, if there is to be a change of the prohibition against homestead mortgage lien and debt modification, it should be a legislative one. Last year a bill in both the Senate and House was directed at modifying the current prohibition on home mortgage lien stripping.[30] Again, Congress is purportedly, working on such a bill.

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[29] See, *Sapos v. Provident Institution of Savings*, 967 F.2d 918, 926-929 (3d Cir. 1992). In *Sapos* a Chapter 13 plan's confirmation was denied although the court approved a 506(a) cram down of the mortgage lenders debt. Nevertheless, with regard to the issue of the interplay of 1322(b)(5) and 1325, the court indicated a failure of a Chapter 13 plan to provide for payout of the 506(a) cram down value within the plan would be fatal to confirmation under 1325. *Sapos*, at 928, footnote 1.

[30] The bill would have amended Section 1322(b)(2) by adding the following language:

> " . . . [B]ut the plan may not modify a claim pursuant to Section 506 of a person holding a primary or junior security interest in real property or a manufactured home . . . that is the debtor's principal residence, except that the plan may modify the claim of a person holding such a junior security interest that was undersecured at the time the interest attached to the extent that the interest remains undersecured." S.1985, 102nd Congress, 2d Session, passed by the Senate on June 17, 1992 and referred to the House Judiciary Committee on June 18, 1992.

This bill, which would have been a legislative overruling of the *Bellamy* line of cases, would have addressed many of the issues raised by Amicus, Harold Barkley, Jr.

The change, if any, should be a legislated one precisely because it would require a review of so many sections of the Bankruptcy Code and Rules to accomplish without a total rending of the fabric of the Code.

Moreover, legislative attempts at remedy need not be at the national level alone. The result herein is not inequitable because the debtors' homestead is in the State of Texas where liens on homesteads other than purchase money liens, home improvement loans and real estate tax liens are legislatively and constitutionally prohibited. Any other state that wishes to likewise "protect" their citizens from their own bad business judgment may do so by enacting similar laws to those found in Texas.

CONCLUSION

This Court should affirm the Fifth Circuit's opinion in *Nobelman* because neither 506(a) nor 1322(b)(2) authorize a debtor to "strip down" a homestead mortgage holder's lien in a Chapter 13 plan. The recent *Dewsnup* opinion of this Court established that 506(a), by itself, or in combination with 506(d) could not be used to "strip" a mortgage lien in a chapter 7. Further, *Dewsnup* held that the lienholder's lien passed through a bankruptcy because it is an *in rem* interest that is not subject to bankruptcy discharge.

Since Section 1322(b)(2) prohibits Chapter 13 plans to modify the rights of homestead mortgage holders, and since a "strip down" of the homestead mortgage holder's lien via Section 506(a) has been determined to be unavailable to the Nobelmans, the relief that the Appellants are

seeking cannot be found in the Bankruptcy Code. Moreover, it is not consistent with the general or Chapter 13 provisions of the Code to apply Section 506(a) or 1322(b)(2) as self activating, lien voiding sections.

Respectfully submitted,

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